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COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Electric Utility Industry Restructuring	)	D.P.U. Docket No. 96-25

REPLY COMMENTS IN SUPPORT OF
OFFER OF SETTLEMENT

These comments by New England Power Company ("NEP"), Nantucket Electric Company, and Massachusetts Electric Company ("Mass. Electric") respond to the comments by other intervenors in this proceeding. The reply comments follow the Department's May 1 Order in Docket D.P.U. 96-100 and our initial comments in this case.

Most of the commenters in the case support the Department's approval of the Settlement. Even the majority of those with criticisms do not advocate rejection of the Settlement. Rather, they suggest changes that would better address their concerns or further their interests. Most of those comments can be accommodated or investigated by the Department as part of its generic rulemaking without delaying the Department's approval of the Settlement. For example, the majority of the comments focus on terms and conditions for suppliers and customers, requirements for marketers including affiliates, or standards of conduct that are subject to continuing Department review and modification after the Settlement is approved. Other comments, such as NEPOOL reform and transmission priorities, are subject to continuing proceedings at the Federal Energy Regulatory Commission. Finally, the comments related to central elements of the Settlement are relatively limited, and ignore the careful accommodation of interests that is necessary to produce a reasonable agreement on the complex issues associated with industry restructuring.

I. Reduced Rates for Customers.

As explained in our initial comments, the Department's primary objective for utility restructuring is reduced rates for customers, and reduced rates are produced by the Settlement. Specifically, the Settlement lowers total bills to standard offer customers by ten percent on the retail access date, and then caps prices at inflation. IRATE believes the rate decrease is too small, and the AFL-CIO thinks that it is too uncertain (p. 9).

Both are incorrect. Contrary to the AFL-CIO's assertion the rate decrease is a "false promise"; its economic value is assured. Although the inflation cap for standard offer service is subject to adjustments for a fuel index after the turn of the century, accounting and tax changes, and an earnings floor, the price trajectory does not recognize the larger countervailing <u>decreases</u> associated with the residual value credit and the opportunity to move to the market. Both of these factors are significant. Under the Settlement, the average cost for regulated delivery services actually declines over the next seven years -- before any residual value credit is applied. The averages, determined by adding lines 1-3 of exhibit 2 to our initial comments, are shown on the following table:

Year	Average ¢/KWH @ 3% Inflation
1998	6.1¢
1999	6.1
2000	6.1
2001	5.9
2002	6.0
2003	5.9
2004	5.9

The residual value credit will be a direct reduction to these prices. In addition, all customers will have the opportunity to purchase power at competitive market prices on January 1, 1998, and to achieve greater savings than standard offer service will provide. Customers will have a full opportunity to move away from the escalating standard offer prices as we transition to a fully competitive market.

Despite the complaints by customer groups that the standard offer prices are too high, marketers contend that the prices are too low. Wheeled Electric Power and Freedom Energy both complain that the standard offer impedes their ability to compete in the market. The standard offer prices by Mass. Electric are well above the retail market prices experienced in the pilot programs in New England. They escalate rapidly into the future and are designed to encourage a reasonable transition to the market by customers.

The only support for the contention that the standard offer prices are too low comes from Mr. Sabatino's survey of eight wholesale power contracts executed by Northeast Utilities over the past several years by utilities who are not yet subject to retail competition. (See Wheeled Elec. Power Comments, App, pp. 6-7). These prices are above those proposed by both Wheeled Electric Power and Freedom Energy in New England's pilot programs and well above the lowest prices quoted in those open, competitive, and market priced tests. Finally, the prices quoted by Mr. Sabatino are also well above NEP's projections of market prices at the retail level. As documented in the response to DPU-1-7, NEP projects prices that are below the standard offer over its seven year term, demonstrating that the standard offer will not interfere with market supplies and that customers will have a real opportunity to realize savings beyond those projected for standard offer customers. A comparison between the standard offer prices and the forecast of market price at retail is shown in the following table:

Calendar Year	Standard Offer Price	Market Projection (Including Losses)	Difference
1998	2.8¢	2.8¢	(0.0¢)
1999	3.1	3.0	(0.1)
2000	3.4	2.9	(0.5)
2001	3.8	3.1	(0.7)
2002	4.2	3.5	(0.7)
2003	4.7	4.1	(0.6)
2004	5.1	4.2	(0.9)

Thus, both the actual market from the pilot programs and a forward looking estimate of market prices under retail competition demonstrate that the standard offer prices will allow competition to proceed and will produce further savings to customers.

There is of course a chance that changing economic conditions or circumstances may cause market prices to increase beyond our forecast. In that event, the protection of the fixed price stream from the standard offer will produce the price assurance for which the Attorney General and other consumer representatives bargained, and the Settlement will have proven its value for customers even though suppliers face tighter margins on their sales.

In short, the prices in the standard offer represent a careful balance between customer protection and the support of the transition to competition. By definition, the balance can never be fully satisfactory to both consumers and suppliers. However, the compromise reached in the Settlement is reasonable given the actual experience from the pilot programs and a forward looking estimate of market prices. The prices and the rates reflected in the Settlement should be approved by the Department.

II. NEPOOL Reform.

The Competitive Power Coalition raised a concern about NEPOOL reform in a letter sent to the NEPOOL Review Committee that was attached to its comments. As stated in our Initial Comments (pp. 7-8), and recognized by the DOER (pp. 27-28) and the Competitive Power Coalition itself, the Settlement is not conditioned on the adoption of the NEPOOL reforms set forth in Attachment 11 and parties are not precluded from taking positions different from those set forth in the document. For this reason, and because NEPOOL reforms will ultimately be resolved by FERC in any event, the Competitive Power Coalition's comments provide no ground for rejecting the Settlement.

III. Jurisdiction Over Transmission and Distribution.

Only DOER commented on the proposed separation of transmission and distribution facilities in the proposed Settlement (DOER Comments, pp. 28-29), and it supports the division recommended in Attachment 12. Accordingly, this aspect of the Settlement is not disputed at this time.

IV. Transmission and Distribution Pricing.

Xenergy voiced the primary complaint about transmission pricing and terms, contending that NEP "hoarded" transmission during the implementation of the Pilot Program. (Xenergy Comments, pp. 2-9). Xenergy's contention is simply false. During the pilot program, Xenergy received its fair allocation of capacity over the tie to New York based on the percentage of load served by Xenergy of Mass. Electric's total load. This allocation is consistent with NEP's open access transmission tariff and FERC's policies under Order 888. Following the Retail Access Date, this load-based allocation will allow all suppliers access to limited interfaces based on the percentage of load served. The procedure fairly allocates transmission capacity over limited interfaces; and, in any event, it is subject to continuing review by FERC. Xenergy's complaint was groundless when applied to the pilot program; it forms no basis for rejecting the Settlement.

Several other commenters, including Enron, Federated Department Stores, and the DOER have suggested that transmission services should be unbundled or provided and billed separately from distribution services for customers. This approach should not be required now for several reasons. First, it could complicate the transition to retail choice and produce unnecessary customer confusion if customers were required to buy transmission service from NEP under FERC approved tariffs and distribution service from Mass. Electric. Second, unbundling is not necessary to implement retail access or "unbundle" supply from regulated wires service in the Settlement. Third, to the extent unbundling requires different cost allocations in rates or creates the potential for bypass, it is inconsistent with the principles set forth in the Department's May 1 order. Fourth, unless done carefully, unbundling of transmission service could eliminate diversity benefits that are today shared by all customers. Fifth, unbundling of transmission imposes another layer of complexity to the settlement process for supplies to retail customers.

Sixth, the cost allocation methodologies used for transmission in the unbundled tariffs are consistent with established, Department approved techniques, under which large users get credits for high voltage metering, high voltage delivery, and service at 115 kV on the same basis as those credits are calculated today. As a result, unbundling of transmission, is neither necessary for fair rates nor on the critical path to retail choice.

The Settlement recognizes that issues concerning transmission pricing and access are ultimately subject to FERC's jurisdiction. (Vol. 2, pp. 9-10). If FERC should decide to require the unbundling of transmission, then the Settlement provides that NEP and Mass. Electric will modify their proposed Transmission Service Agreement accordingly. The Department should therefore not let transmission unbundling interfere with the timely implementation of retail choice. It should approve the Settlement.

V. Corporate Structure, the Divestiture of Generation, and the Standard Offer.

Nearly all the commenters support the divestiture of the generation business as agreed to in the Settlement. As we explained in our initial comments, the divestiture is being undertaken voluntarily by NEP in consideration of stranded cost recovery and the other features of the Settlement. Contrary to the suggestions by many parties, the Settlement may not be evaluated on a piecemeal basis. The Department must look at the Agreement as a whole, and approve or reject it on that basis. Voluntary divestiture is one concession among many that should be factored into that evaluation.

Despite divestiture, several parties still register complaints. The Competitive Power Coalition recognizes that nothing in the Settlement prevents Mass. Electric from re-entering the generation business, but "strongly contends" that nothing in the Settlement prevents any party from arguing against such reintegration before appropriate regulatory agencies. The Coalition is correct; nothing in the Settlement prevents any party from opposing reintegration if Mass. Electric should ever propose it.

The Competitive Power Coalition and Intercontinental Energy Corporation also complain about the financing approvals included in the Settlement. The financing approvals are intended to maintain the priority that secured creditors enjoy today in the revenues of the company in the event of default. This priority for secured creditors is necessary to allow financing on reasonable terms after divestiture. Nothing in the financing arrangements detracts from the basic settlement provisions under which existing contractual obligations with independent power producers are honored in full. The suggestions by CPC and IES are not necessary to meet those contractual obligations, but are designed to carve purchased power contracts out from the claims of secured creditors. The proposals for an improved credit position for contract suppliers is neither appropriate nor necessary. It provides no reason for rejecting the Settlement.

Finally, Enron Capital and Trade Resources and Alternate Power Source, Inc. both complain about the terms of the standard offer bidding. Enron wonders whether NEP or its successor will be able to bid for the standard offer. The answer is “yes”. Under the Settlement, NEP is free to bid in such auction at prices less than those set forth for default supplies. (Vol 2, p. 14). By the time that the standard offer auction occurs in the fall of 1997, NEP expects to have selected a purchaser for its generating business. The purchaser should have the same right as any other supplier to bid in the standard offer at market prices. Nuclear entitlements that are not sold and power contracts that are not assigned represent exceptions to the right to bid. These power supplies must be sold to nonaffiliates in the wholesale power market unless they are necessary to meet the zero bid obligations under the Settlement. (See Vol. 1, pp. 48-50).

Enron also seeks additional detail on the alternative auction and bidding requirements. The alternative auction is designed to provide bidders with the option of making separate bids for each year of the auction, rather than a single seven year bid. As such, the alternative auction addresses the concern of Alternate Power Source, Inc. by allowing generators with excess capacity today to bid low in the early years, while allowing others that plan to build new units to bid low in later years. This process can result in an attractive combined bid. The alternative auction bids will be evaluated at the same time as the basic auction bids, and the supplier need not bid in every year to participate. The details of the auction will be supplied to the parties in March, 1997, well before the bids are due in September, providing suppliers with ample opportunity to understand the process and make appropriate power supply arrangements.

IV. Municipal Light Departments, Load Aggregators, and Standards of Conduct.

As we made clear in our initial comments, nothing in the Settlement affects or restricts the load aggregation by any marketer. (Comments, pp. 13-15). Rather, the Settlement contemplates that the Department will set the rules for marketers generically, and that these rules would govern marketing to customers after the Retail Access Date. The Settlement does, however, commence the process of separation on Mass. Electric's system by requiring Mass. Electric to adopt the standards of conduct included in Attachment 14 (Vol. 3, pp. 238-43), and makes it clear that nothing in the Settlement precludes affiliates of Mass. Electric from marketing electricity, other energy sources, or energy services to customers within or outside Mass. Electric's service territory.

In these respects, the Settlement is entirely consistent with the Department's proposed regulations. Nothing in the Department's proposed regulations or May 1 Order preclude distribution companies from having marketing affiliates (Order, pp. 34-36, 220 C.M.R. § 11.07). The contemplates that Mass. Electric's marketing affiliate will be treated as any other marketer and will be subject to whatever regulations the Department may develop for affiliates.

Under the Settlement, the standards must be adopted as company policy on the date that the Settlement is approved, but Department approval of the standards is not a condition of the Settlement. (Vol. 1, p. 34). As a result, the comments by the parties to this case can be considered by the Department generically in the rulemaking proceeding, and Mass. Electric will make any modifications to the standards necessary to bring its policies into compliance with the Department's rules. (See DOER Comments, p. 29 for a similar suggestion). For this reason, it is unnecessary for the Department to address and resolve all of the comments on the standards of conduct in the context of the Settlement. Specifically, the recommendations of the Competitive Power Coalition (pp. 4-5, Att. A), Enron (pp. 15-16), the DOER (pp. 29-33) and Xenergy (pp. 9-12) should all be considered in the context of generic requirements rather than in the context of this Settlement approval.[1] Those rules and standards should be in place well before January 1, 1998, the date for retail access under the Settlement.

Properly designed standards of conduct address the concerns about marketing affiliates expressed by Wheeled Electric Power Company (pp. 10-17). Wheeled Electric Power would prohibit any affiliate of Mass. Electric from participating in the market. Wheeled Electric's primary complaint is that Mass. Electric's affiliate may be able to provide better service to customers at a lower cost because it knows the territory. This kind of competition should be encouraged by the Department, not prohibited. Marketing through separate affiliates subject to strict standards of conduct should be allowed as a matter of policy. The Settlement, however, does not go that far. The Settlement makes Mass. Electric's marketing affiliate subject to the same rules, terms, and conditions that the Department adopts for all marketers and marketing affiliates in its generic rules. The Settlement only makes it clear that nothing in the Settlement itself prevents affiliates of Mass. Electric from marketing electricity, other energy, or other energy services to customers within or outside its territory. (Vol. 1, p. 53). This provision of the Settlement is reasonable and appropriate. The Department should address issues associated with marketers and marketing affiliates generically, and not in the context of this Settlement.

[1]Xenergy also expresses a concern that conservation programs will be used to support marketing by affiliates (pp. 12-14). Mass. Electric agrees that demand side programs should be provided to all customers on a nondiscriminatory basis and without regard to the customer's supplier of electricity. Assurances that programs are implemented without discrimination should be developed and implemented in proceedings on demand side programs and budgets.

VII. Environmental Issues.

The Department of Environmental Protection, Center for Energy and Economic Development, and MASSPIRG all commented on the environmental provisions of the Settlement. The DEP correctly recognizes that the Settlement does not preclude the implementation of more stringent standards by the DEP -- standards which if adopted by the DEP would "quickly render MECO's proposed environmental commitments obsolete." (DEP's Comments, p. 2). The environmental standards in the Settlement are not intended to supplant environmental regulation. (Vol. 1, p. 42). Rather, the Settlement is intended to guarantee environmental improvements even if more stringent environmental regulations are not adopted.

The DEP also expresses the concern that the environmental commitments carry forward to the new owners of the units. The Settlement is clear. The environmental commitments are intended to and do in fact bind NEP's successors in interest. (Vol. 1, pp. 42, 54; Vol 2, pp. 19-20). The binding nature of the obligations will be detailed in the divestiture plan filing made in July, 1997 that will be subject to the Department's review. Finally, the DEP suggests that the Department bind other suppliers to environmental improvements as well as NEP and its successors. That suggestion is beyond the scope of the Settlement. The Settlement binds only NEP and its successors; other suppliers are not governed by the agreement.

Despite the significant environmental improvements required under the Settlement, MASSPIRG contends that the Settlement does not go far enough. The Settlement goes beyond any other utility's commitment. The approach is designed to provide a model for other, dirtier utilities in the Midwest. If others match NEP's environmental commitments, these other utilities will reduce transport into New England and provide significant emission reductions for all Massachusetts residents. Moreover, as explained above, nothing in the Settlement precludes MASSPIRG from suggesting more stringent emissions limits to environmental regulators.

In contrast, the center for Energy and Economic Development contends the Settlement goes too far toward environmental improvement. It voices concern about the costs associated with the commitment for environmental improvement, the renewables provisions, and the provision on siting reform. These concerns illustrate again the careful compromise that is incorporated in the Settlement. The Settlement represents a balance of conflicting interests. It should be evaluated as an integrated whole.

VIII. Distribution Franchise and Reverse Metering.

The Federated Department Stores suggest (pp. 8-9) that Mass. Electric should waive its Service Extension Discount agreements insofar as they prevent cogeneration as well as purchases from an alternative supplier. The suggestion should be denied. Mass. Electric's contracts with customers were entered into voluntarily, and customers have received significant discounts in exchange for the limitations in the contracts. The circumstances associated with the restriction on purchasing from alternative suppliers has changed, and as a result, a waiver of this requirement is appropriate. However, the circumstances surrounding self generation to bypass the distribution system have not changed. As a result, customers should be held to their voluntary commitments. This aspect of the Settlement is reasonable and should be approved.

IX. Universal and Basic Service.

No party submitted adverse comments on the procedures for supplying universal and basic service in the Settlement. Accordingly, these procedures should be found to be reasonable by the Department.

X. Implementation of Unbundled Rates and Other Rate Design Issues.

No party commented on the unbundling of rates.[2] However, Federated Stores commented on the rate design for the access and transmission charges under the retail delivery service rates that become effective after the Retail Access Date. Both access and transmission charges are allocated in the cost of service using established rate design techniques, and are then reconciled through a flat cents per kilowatthour charge. This approach has been used by the Department to allocate and reconcile Mass. Electric's purchased power expense in the past. It is a reasonable rate design approach, see Trustees of Clark Univ. v. Department of Pub. Utils., 372 Mass. 331 (1977), that is properly included in the Settlement.

XI. Stranded Cost Recovery.

Several parties commented on the stranded cost recovery reflected in the Settlement. MASSPIRG contended that stranded cost recovery should not be allowed. APS and Federated Stores suggest that the access charge be reduced pending the completion of divestiture. As we explained in our initial comments (pp. 17-18), the stranded cost recovery provisions are the central consideration for the Settlement by Mass. Electric and NEP. The Department's approval of these provisions is essential to the continued financial integrity of the Company (see MECO Comments, August 2, 1996, pp. 4-7, 26-30; Tr. 13, pp. 7-12; Feb. 16 Test. M.E. Jesanis pp. 18-19), and is a condition of the Settlement.

Moreover, the stranded cost recovery should not be reduced in anticipation of the sale of the generating business. The approach is not necessary. The Termination Charge Mitigation Incentive in the Settlement (Vol. 2, p. 55) gives NEP a positive financial incentive to divest its

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[2]The AFL-CIO (p. 28) raised a question about the difference in revenues shown on Exhibit PTZ-2 associated with the rate design. That difference stems from the roll-in of the purchased power cost adjustment (PPCA) in the proposed rate designs as authorized in the Settlement (Vol. 1, p. 24) and from differences in fuel and OCA expense between Docket 95-40 and the test period in the Settlement. PPCA revenues are collected through a separate adjustment in present rates, but are collected in base revenues under the proposed rates, producing an increase on the rate design exhibit which has no effect on bills to customers.

generation business on a timely basis and NEP is endeavoring to complete the sale of its generating business by the January 1, 1998 retail access date. (See Response to DPU-1-1). The continued movement along that timeline will lead to the prompt implementation of a residual value credit. This approach implements the credit when it is known, provides an incentive for all parties to complete the process for regulatory approvals on a timely basis, and provides a continued pattern of rate reductions to customers. The procedure set forth in the Settlement is reasonable and should be adopted by the Department.

In addition, comments by the Massachusetts Alliance of Utility Unions and the AFL-CIO both suggest that the Department should recognize employee severance and retraining costs in the contract termination charge. Those provisions are reflected in the agreement. They allow the recovery of reasonable costs that may be negotiated between the Company and its unions. The Department should find that the provisions are properly included in the Settlement Agreement.

The Settlement contains similar provisions for payments in lieu of municipal taxes that assures resources are available for reasonable property tax settlements with communities associated with industry restructuring. These provisions address the comments by the unions on municipal tax issues and are appropriately included in the Settlement.

XII. Energy Efficiency and Renewables.

The comments by the parties on energy efficiency and renewables are discussed under Section VII. Environmental Issues.

XIII. Performance Based Regulation.

The Massachusetts Alliance of Utility Unions focuses on the need for continued training for employees working on the transmission and distribution systems, and expresses a concern that performance based ratemaking will undermine safety (pp. 3-5). Mass. Electric believes that the Settlement will in fact provide adequate resources to maintain the Company's historical commitment to safety and high quality service. The rates built into the Settlement, together with the return on equity floor should provide the continued access to financial resources that will allow Mass. Electric to maintain the high standards of safety and quality that the Company has established throughout its history.[3]

The Department has recognized in its proposed rules that a PBR plan "should not result in reductions in safety, service reliability or existing standards of customer service." (Order, p. 74). The objective is to encourage efficiency, not poor or unsafe service. The Settlement allows Mass. Electric to achieve that objective. It should be approved on that basis.

CONCLUSION

For the reasons stated here and in our Initial Comments in Support of the Offer of Settlement, the Department should approve the Settlement in its entirety.

Respectfully submitted,
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[3]MASSPIRG suggests a similar concern for nuclear safety, and believes that any settlement should provide for a "fair, safe, and responsible shutdown of power plants." The provisions of the Settlement address this issue by providing correct economic incentives to owners of nuclear facilities, implementing a performance standard based on safety indicators, and providing resources for the safe shutdown and decommissioning of nuclear units.